

our use of the terms "small entities" and "small businesses" does not encompass small incumbent LECs. Out of an abundance of caution, however, for regulatory flexibility analysis purposes, we will consider small incumbent LECs within this analysis and use the term "small incumbent LECs" to refer to any incumbent LECs that arguably might be defined by SBA as "small business concerns."⁶⁷⁸

279. The rules adopted in this Order are threefold. First, the rules adjust the methodologies by which a carrier must account for transactions or sales of assets and services with its affiliates ("accounting modifications").⁶⁷⁹ Second, the rules require that BOCs operating separate affiliates under section 272 of the 1996 Act obtain and pay for a Federal/State joint audit every two years by an independent auditor.⁶⁸⁰ Finally, BOC electronic publishing "separated" affiliates must file either a Securities and Exchange Commission ("SEC") Form 10-K or a report "substantially equivalent" to an SEC Form 10-K with the Commission.⁶⁸¹ We consider these in turn.

280. *Accounting Modifications.* We certify that although there are a substantial number of small entities affected by the accounting modifications adopted herein, the accounting modification rules we adopt in this Order will not have a substantial economic impact on those affected small entities. Entities directly subject to the rules adopted herein either provide local exchange and exchange access telecommunications services or are owned by or affiliated with entities that provide such services, and, in the case of smaller incumbent local exchange carriers, settle their NECA cost pool on an actual cost basis. We note that prior to the adoption of this Order, these small entities could already provide nonregulated services and were already subject to our affiliate transactions rules. Neither of the two changes to these rules will have a substantial economic impact on small entities. We note that the accounting modifications adopted here are simply accounting changes with no substantial long-term economic impact. Moreover, we do not believe that the smaller entities that are affected by these rules operate with as many affiliates as do larger entities, and thus the changes will not have a substantial economic impact on small entities. Under the rules modified here, the prevailing price methodology will be retained in a modified form.⁶⁸² Previously, a carrier could use the prevailing price method only when a substantial amount of

⁶⁷⁸ See *id.*

⁶⁷⁹ See discussions in section IV.B.1.b., *supra*.

⁶⁸⁰ See discussion in section IV.B.1.f., *supra*.

⁶⁸¹ See discussion in section IV.B.3.d., *supra*.

⁶⁸² See discussion in section IV.B.1.b.i., *supra*.

business was conducted with third parties. Our previous rules, however, did not clarify the meaning of a "substantial" amount of third-party business for the purpose of determining whether the carrier could set a prevailing price. Under the rules modified here, if an entity's annual sales, as measured by quantity, to unaffiliated third parties exceed 50 percent of total annual sales of a particular product or service then the "substantial" amount of third-party business requirement has been satisfied and a prevailing price has been established for that particular product or service. Also, these entities will have to value assets in a similar manner as they value services. As the companies already are familiar with this method of valuation, there will not be a substantial economic impact from the transition to the new methodology. We therefore certify that the accounting modifications adopted in this Order will not have a significant economic impact on a substantial number of small entities.⁶⁸³

281. *Periodic Audit.* Under the rules adopted herein, a BOC operating a separate subsidiary under section 272 is required to obtain and pay for a biennial Federal/State joint audit conducted by an independent auditor to determine whether the BOC has complied with the rules promulgated under section 272. None of the BOCs is a small entity, since each BOC is an affiliate of a Regional Holding Company ("RHC"), and all of the BOCs or their RHCs have more than 1,500 employees. We therefore certify that the periodic audit requirements adopted in this Order will not have a significant economic impact on a substantial number of small entities.

282. *Filing Form 10-K with the Commission.* Finally, our rules will require that BOC affiliate entities engaged in electronic publishing file a report "substantially equivalent" to an SEC Form 10-K with the Commission. BOC affiliates that already file a Form 10-K with the SEC may satisfy this requirement by simply filing a copy of that Form 10-K with the Commission. BOC affiliates that are not subject to the SEC's 10-K filing requirement, however, must file with the Commission a report containing the same information in the same format as the SEC's Form 10-K. These rules do not apply to small entities because the entities subject to this rule are BOCs or entities associated or affiliated with the BOCs. None of the BOCs is a small entity, since each BOC is an affiliate of a Regional Holding Company ("RHC"), and all of the BOCs or their RHCs have more than 1,500 employees. Moreover, the entities affected by this rule that are affiliated or associated with the BOCs are not independently owned and operated, and therefore do not meet the definition of small entities. We therefore certify that the SEC Form 10-K filing requirement adopted in this Order will not have a significant economic impact on a substantial number of small entities.

⁶⁸³ 5 U.S.C. § 605(b).

283. The Commission shall provide a copy of this certification to the Chief Counsel for Advocacy of the SBA, and include it in the report to Congress pursuant to the SBREFA.⁶⁸⁴ The certification will also be published in the Federal Register.⁶⁸⁵

VII. FINAL PAPERWORK REDUCTION ACT ANALYSIS

284. The decision herein has been analyzed with respect to the Paperwork Reduction Act of 1995, Pub. L. 104-13, and has been approved in accordance with the provisions of that Act.⁶⁸⁶ The Office of Management and Budget ("OMB") encouraged the Commission, to the greatest extent possible, to use its existing cost allocation and affiliate transactions rules to address the requirements established in sections 260 and 271 through 276 of the 1996 Act. Furthermore, OMB recommended that the FCC should, where possible, establish industry and market conditions that, once met, would allow certain provisions of this collection to be eliminated or mitigated. First, we believe we have complied with OMB's request to use the existing cost allocation and affiliate transactions rules wherever possible. We have amended the existing rules only where we are certain that the existing rules will not fulfill the overall goals of the Communications Act of 1934, as amended by the 1996 Act. Second, in accordance with the overall policy underlying the 1996 Act, we will revisit these issues in the future to determine if our regulations are still necessary once competition increases.

⁶⁸⁴ Id. § 801(a)(1)(A).

⁶⁸⁵ Id. § 605(b).

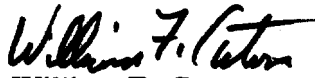
⁶⁸⁶ This Order has been approved under OMB Control Number 3060-0734.

VIII. ORDERING CLAUSES

285. Accordingly, IT IS ORDERED that, pursuant to sections 4(i), 4(j), 201-205, 218, 220, 260, 271-76, 303(r), 403 of the Communications Act of 1934, as amended by the 1996 Act, 47 U.S.C. §§ 154(i), 154(j), 201-205, 218, 220, 260, 271-176, 303(r), 403, the rules, requirements and policies discussed in this Order ARE ADOPTED and sections 32.27, 53.209, 53.211, and 53.213 of the Commission's rules, 47 C.F.R. §§ 32.27, 53.209, 53.211, and 53.213 ARE AMENDED as set forth in Appendix B.

286. IT IS FURTHER ORDERED that the requirements and regulations established in this decision shall become effective upon approval by OMB of the new information collection requirements adopted herein, but no sooner than thirty days after publication in the Federal Register.

FEDERAL COMMUNICATIONS COMMISSION


William F. Caton
Acting Secretary

List of Commenters in CC Docket No. 96-150

AT&T Corp. ("AT&T")
Alarm Industry Communications Committee ("AICC")
American Public Communications Council ("APCC")
Ameritech Operating Companies ("Ameritech")
Association of Telemessaging Services International ("ASTI")
Bell Communications Research, Inc. ("Bellcore")
Bell Atlantic Telephone Companies ("Bell Atlantic")
BellSouth Corporation and BellSouth Telecommunications, Inc. ("BellSouth")
Cincinnati Bell Telephone Company ("Cincinnati Bell")
Competitive Telecommunications Association ("CTA")
Florida Public Service Commission ("Florida PSC")
GTE Service Corporation and its affiliated domestic telephone operating, long distance and wireless companies ("GTE")
General Services Administration ("GSA")
Kiesling Associates LLP ("Kiesling")
LDDS Worldcom ("Worldcom")
MCI Telecommunications Corporation ("MCI")
Missouri Public Service Commission ("Missouri PSC")
NYNEX Telephone Companies ("NYNEX")
National Association of Regulatory Utility Commissioners ("NARUC")
National Newspaper Association ("NNA")
New York State Department of Public Service ("NYDPS")
Newspaper Association of America ("NAA")
Pacific Telesis Group ("PacTel")
People of State of California & Public Utilities Commission of the State of California ("California")
Public Service Commission of Wisconsin ("Wisconsin PSC")
Puerto Rico Telephone Company ("Puerto Rico Telephone")
SBC Communications Inc. ("SBC")
Sprint Corporation ("Sprint")
Telecommunications Resellers Association ("TRA")
U S West, Inc. ("US West")
United State Telephone Association ("USTA")
Voice Tel ("Voice-Tel")
Yellow Pages Publishers Association ("YPPA")

List of Reply Commenters in CC Docket No. 96-150

AT&T Corp. ("AT&T")
American Public Communications Council ("APCC")
Ameritech Operating Companies ("Ameritech")
Bell Atlantic Telephone Companies ("Bell Atlantic")
BellSouth Corporation and BellSouth telecommunications, Inc. ("BellSouth")
Economic Strategy Institute ("ESI")
Florida Public Service Commission ("Florida PSC")
GTE Service Corporation and its affiliated domestic telephone operating, long distance and wireless companies ("GTE")
General Services Administration ("GSA")
LDDS Worldcom ("Worldcom")
MCI Telecommunications Corporation ("MCI")
Missouri Public Service Commission ("Missouri PSC")
Newspaper Association of America ("NAA")
NYNEX Telephone Companies ("NYNEX")
Pacific Telesis Group ("PacTel")
Public Utilities Commission of Ohio ("Ohio")
RBOC Payphone Coalition ("Coalition")
SBC Communications Inc. ("SBC")
Sprint Corporation ("Sprint")
Telecommunications Industry Association ("TIA")
US West, Inc. ("US West")
United States Telephone Association ("USTA")
Washington Utilities and Transportation Commission ("Washington")

Final Rules

AMENDMENTS TO THE CODE OF FEDERAL REGULATIONS

1. Part 32 of Title 47 of the Code of Federal Regulations (C.F.R.) is amended to read as follows:

**PART 32 -- UNIFORM SYSTEM OF ACCOUNTS
FOR TELECOMMUNICATIONS COMPANIES**

Subpart B - General Instructions

§ 32.27 Transactions with affiliates.

* * * * *

(b) Assets sold or transferred between a carrier and its affiliate pursuant to a tariff, including a tariff filed with a state commission, shall be recorded in the appropriate revenue accounts at the tariffed rate. Non-tariffed assets sold or transferred between a carrier and its affiliate that qualify for prevailing price valuation, as defined in part (d) below, shall be recorded at the prevailing price. For all other assets sold by or transferred from a carrier to its affiliate, the assets shall be recorded at the higher of fair market value and net book cost. For all other assets purchased by or transferred to a carrier from its affiliate, the assets shall be recorded at the lower of fair market value and net book cost. For purposes of this section carriers are required to make a good faith determination of fair market value.

(c) Services provided between a carrier and its affiliate pursuant to a tariff, including a tariff filed with a state commission, shall be recorded in the appropriate revenue accounts at the tariffed rate. Non-tariffed services provided between a carrier and its affiliate pursuant to publicly-filed agreements submitted to a state commission pursuant to section 252(e) of the Communications Act of 1934 or statements of generally available terms pursuant to section 252(f) shall be recorded using the charges appearing in such publicly-filed agreements or statements. Non-tariffed services provided between a carrier and its affiliate that qualify for prevailing price valuation, as defined in part (d) below, shall be recorded at the prevailing price. For all other services provided by a carrier to its affiliate, the services shall be recorded at the higher of fair market value and fully distributed cost. For all other services received by a carrier from its affiliate, the service shall be recorded at the lower of fair market value and fully distributed cost, except that services received by a carrier from its affiliate that exists solely to provide services to members of the carrier's corporate family shall be recorded at fully distributed cost. For purposes of this section carriers are required to make a good faith determination of fair market value.

(d) In order to qualify for prevailing price valuation in sections (b) and (c) of this rule, sales of a particular asset or service to third parties must encompass greater than 50 percent of the total quantity of such product or service sold by an entity. Carriers shall apply this 50 percent threshold on a asset-by-asset and service-by-service basis, rather than on a product line or service line basis. In the case of transactions for assets and services subject to section 272, a BOC may record such transactions at prevailing price regardless of whether the 50 percent threshold has been satisfied.

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2. Part 53 of Title 47 of the C.F.R. is added to read as follows:

**PART 53 -- SPECIAL PROVISIONS CONCERNING
BELL OPERATING COMPANIES**

Subpart C - Separate Affiliate; Safeguards.

§ 53.209 Biennial audit

(a) A Bell operating company required to operate a separate affiliate under section 272 of the Act shall obtain and pay for a Federal/State joint audit every two years conducted by an independent auditor to determine whether the Bell operating company has complied with the rules promulgated under section 272 and particularly the audit requirements listed in paragraph (b) of this section.

(b) The independent audit shall determine:

(1) Whether the separate affiliate required under section 272 of the Act has:

(i) Operated independently of the Bell operating company;

(ii) Maintained books, records, and accounts in the manner prescribed by the Commission that are separate from the books, records and accounts maintained by the Bell operating company;

(iii) Officers, directors and employees that are separate from those of the Bell operating company;

(iv) Not obtained credit under any arrangement that would permit a creditor, upon default, to have recourse to the assets of the Bell operating company; and

(v) Conducted all transactions with the Bell operating company on an arm's length basis with the transactions reduced to writing and available for public inspection,

(2) Whether or not the Bell operating company has:

(i) Discriminated between the separate affiliate and any other entity in the provision or procurement of goods, services, facilities, and information, or the establishment of standards;

(ii) Accounted for all transactions with the separate affiliate in accordance with the accounting principles and rules approved by the Commission.

(3) Whether or not the Bell operating company and an affiliate subject to section 251(c) of the Act:

(i) Have fulfilled requests from unaffiliated entities for telephone exchange service and exchange access within a period no longer than the period in which it provides such telephone exchange service and exchange access to itself or its affiliates;

(ii) Have made available facilities, services, or information concerning its provision of exchange access to other providers of interLATA services on the same terms and conditions as it has to its affiliate required under section 272 that operates in the same market;

(iii) Have charged its separate affiliate under section 272, or imputed to itself (if using the access for its provision of its own services), an amount for access to its telephone exchange service and exchange access that is no less than the amount charged to any unaffiliated interexchange carriers for such service; and

(iv) Have provided any interLATA or intraLATA facilities or services to its interLATA affiliate and made available such services or facilities to all carriers at the same rates and on the same terms and conditions, and allocated the associated costs appropriately.

(c) An independent audit shall be performed on the first full year of operations of the separate affiliate required under section 272 of the Act, and biennially thereafter.

(d) The Chief, Common Carrier Bureau, shall work with the regulatory agencies in the states having jurisdiction over the Bell operating company's local telephone services, to attempt to form a Federal/State joint audit team with the responsibility for overseeing the planning of the audit as specified in section 53.211 and the analysis and evaluation of the audit as specified in section 53.213. The Federal/State joint audit team may direct the independent auditor to take any actions necessary to ensure compliance with the audit requirements listed in paragraph (b) of this section. If the state regulatory agencies having jurisdiction choose not to participate in the Federal/State joint audit team, the Chief, Common Carrier Bureau, shall establish an FCC audit team to oversee and direct the independent auditor to take any actions necessary to ensure compliance with the audit requirements in paragraph (b) of this section.

§ 53.211 Audit planning.

(a) Before selecting a independent auditor, the Bell operating company shall submit preliminary audit requirements, including the proposed scope of the audit and the extent of compliance and substantive testing, to the Federal/State joint audit team organized pursuant to section 53.209(d);

(b) The Federal/State joint audit team shall review the preliminary audit requirements to determine whether it is adequate to meet the audit requirements in paragraph (b) of section 53.209. The Federal/State joint audit shall have 30 days to review the audit requirements and determine any modifications that shall be incorporated into the final audit requirements.

(c) After the audit requirements has been approved by the Federal/State joint audit team, the Bell operating company shall engage within 30 days an independent auditor to conduct the biennial audit. In making its selection, the Bell operating company shall not engage any independent auditor who has been instrumental during the past two years in designing any of the accounting or reporting systems under review in the biennial audit.

(d) The independent auditor selected by the Bell operating company to conduct the audit shall develop a detailed audit program based on the final audit requirements and submit it to the Federal/State joint audit team. The Federal/State joint audit team shall have 30 days to review the audit program and determine any modifications that shall be incorporated into the final audit program.

(e) During the course of the biennial audit, the independent auditor, among other things, shall:

(1) Inform the Federal/State joint audit team of any revisions to the final audit program or to the scope of the audit.

(2) Notify the Federal/State joint audit team of any meetings with the Bell operating company or its separate affiliate in which audit findings are discussed.

(3) Submit to the Chief, Common Carrier Bureau, any accounting or rule interpretations necessary to complete the audit.

§ 53.213 Audit analysis and evaluation.

(a) Within 60 dates after the end of the audit period, but prior to discussing the audit findings with the Bell operating company or the separate affiliate, the independent auditor shall submit a draft of the audit report to the Federal/State joint audit team.

(1) The Federal/State joint audit team shall have 45 days to review the audit findings and audit workpapers, and offer its recommendations concerning the conduct of the audit or the audit findings to the independent auditor. Exceptions of the Federal/State joint audit team to the finding and conclusions of the independent auditor that remain unresolved shall be included in the final audit report.

(2) Within 15 days after receiving the Federal/State joint audit team's recommendations and making appropriate revisions to the audit report, the independent auditor shall submit the audit report to the Bell operating company for its response to the

audit findings and send a copy to the Federal/State joint audit team. The independent auditor may request additional time to perform additional audit work as recommended by the Federal/State joint audit team.

(b) Within 30 days after receiving the audit report, the Bell operating company will respond to the audit findings and send a copy of its response to the Federal/State joint audit team. The Bell operating company's response shall be included as part of the final audit report along with any reply that the independent auditor wishes to make to the response.

(c) Within 10 days after receiving the response of the Bell operating company, the independent auditor shall make available for public inspection the final audit report by filing it with the Commission and the state regulatory agencies participating on the joint audit team.

(d) Interested parties may file comments with the Commission within 60 days after the audit report is made available for public inspection.